



GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Fiscal Note 2011 Biennium

Bill #	HB0507	Title:	Require market conduct & financial exams by ins. commissioner of state fund
Primary Sponsor:	Reinhart, Michele	Status:	As Introduced

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|---|--|--|
| <input type="checkbox"/> Significant Local Gov Impact | <input checked="" type="checkbox"/> Needs to be included in HB 2 | <input checked="" type="checkbox"/> Technical Concerns |
| <input type="checkbox"/> Included in the Executive Budget | <input type="checkbox"/> Significant Long-Term Impacts | <input type="checkbox"/> Dedicated Revenue Form Attached |

FISCAL SUMMARY

	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>	<u>FY 2012 Difference</u>	<u>FY 2013 Difference</u>
Expenditures:				
State Special Revenue (SAO)	\$333,788	\$113,438	\$116,278	\$350,686
Proprietary (MSF)	\$405,850	\$187,747	\$192,909	\$429,736
Revenue:				
General Fund	\$0	\$0	\$0	\$0
State Special Revenue (SAO)	\$333,788	\$113,438	\$116,278	\$350,686
Proprietary (MSF)	\$405,850	\$187,747	\$192,909	\$429,736
Net Impact-General Fund Balance:	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

Description of fiscal impact:

Montana State Fund (MSF) would be required to incur the expense for examinations of the affairs, transactions, accounts, records, and assets of MSF as considered advisable by the Insurance Commissioner. Examinations in regard to sales, advertising, rates, surplus, and handling of claims, would occur not less frequently than once every five years, and indepth financial examinations every five years. The Insurance Commissioner would have the examinations conducted and MSF would be required to pay for all costs associated with the examinations. All MSF revenues are generated from premiums charged to policyholders and investment income. Expenses are included when establishing annual rates.

FISCAL ANALYSIS

Assumptions:

State Auditor's Office (SAO)

1. 33-1-408, MCA, indicates that the NAIC examiners handbook is to be followed in completing the examinations.

2. Market conduct examinations may run between 160 hours and 4,000 hours depending on the size of the company and the scope and complexity of the examination. It is estimated to conduct a market conduct examination of Montana State Fund will be 4,000 hours.
3. SAO would request 1.00 FTE beginning in FY 2010 for an accredited insurance examiner to conduct the market conduct examination. Personal service and operating costs are approximately \$67,788 for FY 2010, \$63,438 FY 2011, \$65,028 FY 2012, and \$66,655 FY 2013. If SAO was to contract for a fully accredited independent outside examiner the hourly rate is \$165 or \$600,000 per examination.
4. HB 507 proposes to move the responsibility to SAO to conduct actuarial analysis rather than the LAD. SAO will contract with an independent actuary to conduct a detailed actuarial analysis of the State Fund. SAO assumes the cost will be \$50,000 annually. The actuarial analysis would include a detailed analysis of the premium determination rules and rates at the class level.
5. SAO will contract for a financial examination of MSF once every three years.
6. It is estimated that a financial examination of State Fund will take approximately 1,200 hours at \$150 per hour plus travel expenses. Financial examinations would be conducted once every three years with an approximate cost of \$216,000 in FY 2010.
7. An inflationary rate of 2.5% has been applied for FY 2012 and FY 2013.
8. Title 33 allows SAO to recover costs associated with examinations.

Montana State Fund (MSF):

9. Expenses for *examinations of sales, advertising, rates, surplus and handling of claims* will first be incurred by MSF in FY 2010 and will occur in subsequent years.
10. Expenses for the indepth *financial examination* will be incurred by MSF in FY 2010 and every third year thereafter.
11. MSF would be required to keep a record of all complaints.
12. Based on information State Auditor's Office shared with LAD and from MSF contacts with a service provider, examinations could take three to six months depending on the scope of the review and include a team of about five staff. Examination preparation, staff coordination, follow-up reporting, and monitoring or implementing potential process adjustments will require 1.00 FTE for a Compliance Officer position for MSF. This position will also be responsible for coordinating the financial examination every three years. The position will require a professional certification, such as a CPA, to coordinate the examinations with SAO, LAD, contractors, and MSF staff. Total cost for personal services and operating expenses of the position are estimated to be: \$79,492 - FY 2010; \$75,154 – FY 2011; \$77,497 – FY 2012; and, \$79,937 – FY 2013.
13. Based on estimates provided to MSF from a consultant certified and experienced in performing *financial examinations*, MSF used the following assumptions:
 - a. *Financial Examination*: The financial examination to take place in FY 2010 would require 1,200 hours at \$150 per hour plus 20% for associated expenses for a total cost of \$216,000. The subsequent financial examination will not occur until FY 2013.
14. Based on discussions with SAO, they disclosed the following estimates for market conduct examinations.
 - a. *Market Conduct Examinations*: will cost approximately \$80,000 per year.
15. All MSF revenues are generated from premiums charged to policyholders and investment income. Expenses are included when establishing annual rates.
16. Findings of all examinations are to be reported by the Insurance Commissioner to the Governor, the Legislature, and the Board of Directors of the State Fund.
17. Section 3 of the bill repeals 39-71-2361, MCA, that provides for annual financial and compliance audits of MSF. The Legislative Auditor will conduct a financial and compliance audit of MSF every two years as provided for in 5-13-304, MCA and has all of the authority for additional audits of MSF as provided for in Title 5, Chapter 13, Part 3, Legislative Auditor.

Legislative Branch:

18. The independence standard contained in generally accepted government auditing standards issued by the United States Government Accountability Office does not permit the Legislative Audit Division to solely rely on the information contained in the examination under section 1(1)(a) for the purposes of conducting a financial and compliance audit.
19. Section 3 repeals 39-71-2361, MCA, and eliminates the requirement to conduct a financial and compliance audit including evaluation of the claims reservation process, the amounts reserved, and the current report of the state fund's actuary on an annual basis.
20. Under 39-71-2314, MCA, "the state fund is subject to laws that generally apply to state agencies, including but not limited to...Title 5, chapter 13" which provides the Montana State Fund is subject to a financial and compliance audit..."every 2 years covering the two-year period since the last audit, unless otherwise required by state law."
21. The Legislative Audit Division will perform a financial and compliance audit of the state fund on a biennial basis. Since the Montana State Fund is material to the state's basic financial statements or Comprehensive Annual Financial Report (CAFR), and the CAFR requires annual audits by the Legislative Audit Division, portions of the State Fund biennial financial and compliance audit will be performed annually to cover the areas material to the CAFR.
22. Montana State Fund will continue to pay for audit costs under 5-13-402, MCA.

Montana State Fund (MSF)

	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>	<u>FY 2012 Difference</u>	<u>FY 2013 Difference</u>
<u>Fiscal Impact MSF:</u>				
FTE MSF	1.00	1.00	1.00	1.00
<u>Expenditures MSF:</u>				
Personal Services	\$72,062	\$74,309	\$76,631	\$79,050
Operating Expenses	\$7,430	\$845	\$866	\$887
Operating Expenses-Examinations	\$326,358	\$112,593	\$115,412	\$349,799
TOTAL Expenditures	\$405,850	\$187,747	\$192,909	\$429,736
<u>Funding of Expenditures MSF:</u>				
Proprietary	\$405,850	\$187,747	\$192,909	\$429,736
TOTAL Funding of Exp.	\$405,850	\$187,747	\$192,909	\$429,736
<u>Revenues MSF:</u>				
Proprietary	\$405,850	\$187,747	\$192,909	\$429,736
TOTAL Revenues	\$405,850	\$187,747	\$192,909	\$429,736

State Auditor's Office (SAO)

	<u>FY 2010 Difference</u>	<u>FY 2011 Difference</u>	<u>FY 2012 Difference</u>	<u>FY 2013 Difference</u>
<u>Fiscal Impact:</u>				
FTE SAO	1.00	1.00	1.00	1.00
<u>Expenditures SAO:</u>				
Personal Services	\$52,949	\$52,949	\$54,273	\$55,630
Operating Expenses	\$280,839	\$60,489	\$62,005	\$295,056
TOTAL Expenditures	\$333,788	\$113,438	\$116,278	\$350,686
<u>Funding of Expenditures SAO:</u>				
State Special Revenue (02)	\$333,788	\$113,438	\$116,278	\$350,686
<u>Revenues:</u>				
State Special Revenue (02)	\$333,788	\$113,438	\$116,278	\$350,686

Net Impact to Fund Balance (Revenue minus Funding of Expenditures) SAO and MSF:

General Fund (01)	\$0	\$0	\$0	\$0
State Special Revenue SAO	\$0	\$0	\$0	\$0
Proprietary MSF	\$0	\$0	\$0	\$0

Technical Notes:

1. Terminology such as: ‘future financial problems’; ‘may negatively affect results’; and ‘correctness of reported economic data’ are not defined. Additional clarifications or definitions are needed to determine scope, cost impact, and enable compliance by MSF.

Sponsor's Initials

Date

Budget Director's Initials

Date